United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

74-1062 74-1816

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ORIGINAL

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UNITED STATES OF AMERICA and MORTIMER TODEL, as Receiver of the funds, assets and property of Roosevelt Capital Corporation,

Plaintiffs-Appellees,

against

FRANKLIN NATIONAL BANK,

Defendant-Appellant.

Appeal from Memorandum Decision and Order and Judgment of the United States District Court for the Eastern District of New York

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REPLY BRIEF FOR DEFENDANT-APPELLANT, FRANKLIN NATIONAL BANK

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REPLY BRIEF FOR DEFENDANT-APPELLANT, FRANKLIN NATIONAL BANK

Plaintiffs' most frequently cited authority in support of the District Court's judgment is the District Court's own opinion. In its main brief, Franklin set forth numerous reasons why that judgment should be reversed. Plaintiffs' answering brief is simply not responsive. It fails even to mention many of Franklin's arguments, and adequately answers none.

Indeed, the bankruptcy of plaintiffs' position is underscored by the fact that ten years after the event in question and over seven years after this action was commenced, plaintiffs have made a complete about-face. Implicitly acknowledging the weakness of the position they have heretofore advanced, they have now come forward with a new contention—"fraudulent conveyance." However, we will demonstrate below that plaintiffs' new contention is as equally devoid of merit as the ones they originally advanced.

I

The Initial Authorization

Franklin demonstrated in its main brief that the disbursement of the $160,000 from the Roosevelt account was fully authorized, on either of two independently sufficient grounds, namely, express written authorization from the purchasing stockholder, Pierson (Franklin Brief, pp. 10-12) or authorization and approval from the selling stockholders (Franklin Brief, pp. 12-13). We also demonstrated that even if the disbursement to Tolmage was originally unauthorized, it was thereafter ratified by the sole stockholder of Roosevelt (Franklin Brief, pp. 14-19).

1

Plaintiffs' answering brief sweeps under the rug the authorization by the selling stockholders which is established by their own papers. And for good reason! Since plaintiffs labor so mightily to demonstrate that the authorization by the purchasing stockholder, Pierson, was purportedly ineffective because at that split second in time he was

not as yet the sole stockholder of Roosevelt, it stands to reason that the authorization by the selling stockholders is completely dispositive of this entire case. Having no tenable answer to the argument, plaintiffs chose simply to ignore it.

2

As to the authorization by the purchasing stockholder, Pierson, plaintiffs begrudgingly acknowledge that the simultaneous transaction is "conventional" in real estate closings, but attempt to distinguish away the thousands of such daily closings with the cryptic comment that in those situations the "very function of the 'simultaneous' real estate closing is to protect creditors" (Plaintiffs' Brief, p. 16). What relevance the presence or the protection of creditors has on the issue of authority is left to the imagination. And how creditors who are not parties to the transaction are protected in such situations goes unanswered. Be that as it may, the fact remains that under plaintiffs' hair-splitting analysis of the simultaneous transaction, no real estate purchase involving mortgages could be consummated with authority. But simultaneous transactions *do* in fact occur and they are fully recognized in the business and legal world. Consequently, the withdrawal of $160,000 from the Roosevelt account was authorized.

3

Plaintiffs' contention that the letter of instructions signed by Pierson on behalf of Roosevelt was not an order to Franklin to issue checks and charge them against the Roosevelt account flies in face of the uncontroverted rec-

ord. Plaintiffs seemingly quibble over the form of the authorization executed by Roosevelt in connection with the issuance of the two checks. They argue that the letter of authorization did not meet the requirements of Roosevelt's corporate resolution in that it was not a "check, draft, bill of exchange, acceptance, order or other instrument for the payment of money or the withdrawal of funds" (Plaintiffs' Brief, p. 18). To argue that the letter was not an "order * * * for the payment of money" as required under the resolution is simply incredible. The fact is that the letter was for "a sum certain," directed the payment of money via official checks, identified the payee of the checks, and was signed by the authorized signatory of Roosevelt on its behalf. What else could there be?

There remains one possibility—that the addition of the word "please"—a word of common courtesy—transformed the letter's import from an "order" to a "request." Besides the obvious conclusion that the use of words of courtesy cannot deprive a document of legal efficacy, the law specifically provides that the addition of the word "please" does not transform an order into an unenforceable request. See, e.g., the Official Comment to the U.C.C. Section in question.

> "The prefixing of words of courtesy to the direction—as 'please pay' or 'kindly pay'—should not lead to a holding that the direction has degenerated into a mere request." N.Y. Uniform Commercial Code §3-102, Official Comment No. 2 at 8 (McKinney 1964).

Moreover, and totally independent of the foregoing, plaintiffs' position must still fail. Even assuming that the

particular words contained in the resolution did not cover this situation, the fact is that Franklin had the right to rely on *oral* instructions from its depositor for withdrawals from its account. To be sure, Franklin, under its agreement with the depositor, was not required to honor an oral order or instruction but the law is abundantly clear that if Franklin chose to honor such an instruction it would be fully protected.

> "The bank may pay money deposited upon an oral order, or transfer it from one account to another, and such oral order will be a sufficient authority and jurisdiction for so doing * * *." 5A *Michie, Banks and Banking,* Ch. 9, §104 at 285 (1973).

See also, *Estate of McNeal* v. *McNeal,* 75 Wash.2d 103, 449 P.2d 100 (1969); *In re Blose's Estate,* 374 Pa. 100, 97 A.2d 358 (1953); *Lind* v. *Porter,* 46 Idaho 50, 266 P. 419 (1928); *American Nat'l Bank* v. *Miles,* 79 S.W.2d 47 (Mo. App. 1935). See generally, 9 C.J.S. Banks & Banking §331 at 674-75 ("An oral order is sufficient unless the bank demands a written one"); 10 Am. Jur. 2d Banks §469 at 464-65 (1963); Effect of verbal order with respect to payment of check or transfer of bank deposit, Annot., 2 A.L.R. 175 (1919).

Plaintiffs' argument that the original instruction by Pierson could not be ratified is blatant nonsense. Even plaintiffs must acknowledge that if the instruction was initially authorized Franklin would be fully protected. Whether or not such initial authorization, or subsequent ratification, would be "wrongful" vis-a-vis a claim against the stockholders is completely beside the point. Since

Franklin's actions would have been protected if initially authorized, it simply follows that ratification has the same effect.

Additionally, the *sole* basis for the contention that the issuance of the checks against the Roosevelt account could not be ratified is that it was "without consideration" and therefore would reduce the corporation to insolvency. The issues of "without consideration" and "insolvency" will be discussed in detail later in this brief in connection with the new claim of "fraudulent conveyance." Suffice it to say at this point that *there is no basis in the Record whatever—other than plaintiffs' repeated assertion of the charge—that the issuance of the checks to Tolmage against Roosevelt's account was without consideration to Roosevelt and rendered it insolvent.**

Plaintiffs contend that there does not even exist an issue of fact concerning the alleged lack of authority in Franklin to issue the two checks against Roosevelt's account. Yet, at this very moment there is an action pending

* Plaintiffs seem to be advancing an additional argument, namely, that even if Franklin were not the recipient of Roosevelt funds, it would remain liable in damages for "participating in, or at the very least, facilitating, the fraudulent misappropriation of its depositors' funds." (Plaintiffs' Brief, p. 25.) Such a charge, however, has no basis in fact, is not contained in the pleadings, and is not legitimately before the Court at this time. To even attempt to sneak it in via an answering brief on appeal best reflects the lack of credibility to the claim. Interestingly, the complaint herein initially contained an allegation which seemed to argue that Franklin participated in or facilitated the diversion of corporate funds (A. 15), but that allegation was expressly stricken by Judge Weinstein upon the acknowledgment by plaintiffs in open Court that there was no factual basis for such charge (A. 21).

in the United States District Court for the Southern District of New York which was commenced even prior to this action and in which plaintiffs herein are suing both the selling and purchasing stockholders for recovery of the complete assets of Roosevelt, including the $160,000 represented by the two cashier's checks payable to the order of Sidney Tolmage. "*United States of America and Mortimer Todel,* as Receiver of the funds, assets, and property of Roosevelt Capital Corporation, Plaintiffs, v. *Peter Francis Crosby, Ray E. Pierson, S. Lonnie Olanow, Samuel Stone, Stewart Wallen, Joseph Calise, Charles Shapiro, Alexander Eltman, Sidney Tolmage, Arthur V. Briskin, Franklin National Bank, and Morton Held & Company,* Defendants." Civil No. 66-2026 (S.D.N.Y., filed July 8, 1966).* If, as plaintiffs are attempting to convince this Court on this appeal, the withdrawal of the funds by Franklin was unauthorized, then there is no basis for suing both the selling and purchasing stockholders for these funds. Since the plaintiffs have commenced such a suit and continue to prosecute it, it is obvious that they have also taken the position that the withdrawal was authorized. Whichever position plaintiffs will eventually elect to pursue—whether that advanced in the Eastern District or the contrary position in the Southern District—it is simply incredible for the plaintiffs to now tell this Court that the lack of authorization is so patent as to not even rise to the status of a triable issue of fact.

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* Franklin was originally joined in that action as a party defendant but, due to improper venue, was dismissed by order of the Court. Thereafter, the instant action against Franklin was brought by these plaintiffs in the Eastern District of New York.

Plaintiffs' heavy reliance upon the United States Supreme Court decision in *Superintendent of Insurance* v. *Bankers Life & Casualty Co.*, 404 U.S. 6 (1971), is totally misplaced. Contrary to the claim here, *Bankers Life* involved a charge by the plaintiff in his complaint that the corporation was *actually defrauded* by the defendants, in violation of the federal securities laws, into authorizing the sale of securities. As noted by the Supreme Court: "Manhattan's Board of Directors was allegedly deceived into authorizing this sale by the misrepresentation that the proceeds would be exchanged for a certificate of deposit of equal value." 404 U.S. at 8, n. 1.

The Court underscores the deception perpetrated upon the board of directors by "an officer of Manhattan and his outside collaborators" in the following critical language:

> "The crux of the present case is that Manhattan suffered an injury as a result of deceptive practices touching its sale of securities as an investor. As stated in *Shell* v. *Hensley*, 430 F.2d 819, 827:
>
> > " 'When a person who is dealing with a corporation in a securities transaction denies the corporation's directors access to material information known to him, the corporation is disabled from availing itself of an informed judgment on the part of its board regarding the merits of the transaction. In this situation the private right of action recognized under Rule 10b-5 is available as a remedy for the corporate disability.' " 404 U.S. at 12-13.

The Supreme Court made it abundantly clear that the fraud involved in the *Bankers Life* case was not, as claimed

here, that the purchasers of the corporation paid for the stock with the corporation's own funds; rather, the fraud involved a misrepresentation to the corporation that it would receive full value for its portfolio securities. 404 U.S. at 9. The fact that the deception enabled the buyers to purchase the corporation's stock with its own funds was only a consequence of the fraud, not the fraud itself.

Furthermore, the *Bankers Life* complaint specifically charged that *all* the defendants—including the banks—had conspired to defraud the corporation. Paragraph 17 of the complaint reads as follows:

> "Commencing in or about November, 1961, in connection with and in furtherance of a sale of said shares the defendants and/or their officers, agents and representatives unlawfully and with a fraudulent intent conspired and connived to defraud Manhattan, its creditors and policyholders and to that end employed a device, scheme and artifice by which they were able to despoil Manhattan of its assets and dispose of the same to their individual benefit and profit."*

When the *Bankers Life* opinion is fully analyzed, it becomes clear beyond peradventure that plaintiffs' reliance thereon is completely unjustified. Surely, plaintiffs do not claim that Roosevelt was somehow deceived into authorizing the issuance of the checks. Nor, for that matter, does the complaint even charge that Franklin participated in a conspiracy to deceive Roosevelt. And, of course, there isn't a scintilla of evidence supporting such a claim.

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* See also, Complaint, Paragraphs 18, 21, 22, 25, 28, 29, 30, 31, 32, 35, 38.

The New York Court of Appeals case of *Ward* v. *City Trust Co. of N.Y.*, 192 N.Y. 61 (1908), relied upon by plaintiffs as "similar to the instant case" (Plaintiffs' Brief, p. 10), makes the clear distinction between *authorized* and *unauthorized* withdrawals by a corporate signatory for personal use. Thus, the *Ward* court, in reversing a judgment for the defendant bank and ordering a new trial, expressly predicated its ruling on the fact that, under the unique factual circumstances present in that case, the bank should have known that the use of the corporate funds by the president to pay a personal loan was *unauthorized* and had not been ratified by the corporation's board of directors. The court then pointed out that if—*as is true in our situation*—the withdrawal had been authorized or ratified by the corporation, the judgment in favor of the defendant would be allowed to stand. In the court's words:

> "There was no by-law of the Hartman Company, nor any resolution of its board of directors, authorizing the use of its money or assets to pay other than corporate obligations, or ratifying the use made of said check." 192 N.Y. at 67.
>
> * * *
>
> "If, for instance, reasonable inquiry had been made by the trust company and the result had tended to show that the check really belonged to Umsted and Kiefer and not to the Hartman Company, or that Umsted was authorized by that company to use it as he proposed, then, even if the fact were otherwise, such inquiry would have tended to rebut the presumption of illegal use and to protect the title of the trust company." 192 N.Y. at 70.*

* In addition, the Court stressed another factor present in that case and not in ours, namely, that the bank knew that the corporation "was a heavy borrower and that there were creditors with large claims." 192 N.Y. at 74.

Under the *Ward* ruling, it is clear that Franklin was fully justified in issuing the requested bank checks against the Roosevelt account. Not only was the instruction to issue the checks fully authorized by the corporation—via the consent of all the stockholders and the corporate resolution filed with Franklin—the fact is—and this is undisputed —Franklin had no idea of the existence of creditors of Roosevelt and the extent of its liabilities. Consequently, even under the cases cited by plaintiffs, it is Franklin, not plaintiffs, that is entitled to judgment as a matter of law.

II

Fraudulent Conveyances

If, as we have already abundantly demonstrated, both in our main brief and in this brief, the initial issuance of the two checks against Roosevelt's account was fully authorized before the fact or effectively ratified thereafter, then we never even reach the issue of "fraudulent conveyance." Franklin, under such circumstances, not being a "tranferee of a fraudulent conveyance," can obviously not be held liable under the laws governing fraudulent conveyances. All it did was disburse its depositor's funds pursuant to the latter's express request.

We will now show that, over and above the obvious inapplicability of the law of fraudulent conveyances to the facts of our situation, there are additional independently significant legal grounds, both procedural and substantive, barring the application of the law of fraudulent conveyances.

1

First, the law is clear that a complaint seeking to set aside a fraudulent conveyance must allege that the conveyance was either without consideration or for less than fair consideration *and* that it rendered the transferor insolvent. *Mariner Harbor Nat'l Bank* v. *Imperial Beverage Corp.*, 264 App. Div. 785 (2d Dep't 1942); *Empire Boxboard Corp.* v. *Active Paper Box Co.*, 115 N.Y.S.2d 14 (Sup. Ct., Kings Co. 1952). *Both crucial elements of pleading are lacking in this situation.*

2

Second, there is no showing of insolvency here. The insolvency test under the fraudulent conveyance section in question is whether a "present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured." N. Y. Debtor and Creditor Law, §271(1) (McKinney 1945). Here, as we will now show, there is at least a factual issue as to whether the fair salable value of Roosevelt's assets was less than the twenty-year $150,000 debenture liability. When the $160,000 was withdrawn by Roosevelt from its account—even assuming, contrary to the fact, that it was withdrawn without consideration—it left Roosevelt with the following assets and liabilities:

Assets		
Cash on deposit at Roosevelt Field Branch	$ 1,000	
Cash on deposit at Hanover Square Branch (balance of proceeds of Treasury bills)	27,000	
Accounts receivable (loans to small business)	118,000	
	$146,000	
Liabilities		
Twenty-year debenture issued to the United States	$150,000	(A. 60)

However, with respect to this twenty-year debenture, only interest—at the rate of 5% per annum—was payable during *the first ten years.* Thereafter, principal payments were to commence: $5,000 a year for the eleventh through fifteenth year, $12,500 a year for the next four years and a $75,000 payment in the twentieth year (A. 173). Thus, rather than reflecting an insolvent position of $4,000—as plaintiffs would so simplistically urge—Roosevelt was surely far, far from insolvency. Indeed, using 11½% as a conservative estimate of the current prime rate of interest, the present value of a $150,000 loan repayable over a period of twenty years (without a ten-year hiatus in amortization payments) at 5% interest per annum is $92,816.35. Under the circumstances, Roosevelt was clearly not insolvent.

3

Third, as already noted in the first section of this brief, there is no proof whatsoever in this Record that the conveyance referred to herein was "fraudulent." It goes without saying that the conveyance must necessarily have been without fair consideration and have rendered the corporation insolvent to constitute a "fraudulent conveyance." We have already shown above that even if it was totally without consideration, it would not have rendered the corporation insolvent. There is however a much greater defect in plaintiffs' case and that is the total failure of plaintiffs to offer even a scintilla of evidence to the effect that the transfer was *without consideration.* One need not posit many hypotheticals to understand the failing in plaintiffs' case. Thus, for instance, even if—as plaintiffs would have it—the two checks originally constituted a loan by Frank-

lin to Pierson and thereafter Roosevelt paid off Pierson's debt to Franklin, it would still not constitute a "fraudulent conveyance" unless Roosevelt received nothing in return for paying Pierson's loan. If, on the other hand, the payment by Roosevelt to Franklin of Pierson's debt to Franklin was by way of a loan from Roosevelt to Pierson, there would have been full consideration for the payment and there would have been no change whatever in the balance sheet. In short, Roosevelt would have been exchanging a cash receivable into a loan receivable. Under such circumstances, plaintiffs' entire theory of "fraudulent conveyances" disintegrates completely.

By the same token, since the Roosevelt payment could just as easily have been a loan as a gift, plaintiffs' contention that Roosevelt, via Pierson, could not ratify the transfer withdrawal must likewise fail. There is obviously no statutory inhibition to having a corporation loan money to its principal stockholder.

4

Fourth, in light of the close identity between Ray Pierson, as sole stockholder of Roosevelt, and Roosevelt, there is even a question as to whether the payment by the corporation of the individual's debt reflected fair consideration received by the corporation. Cf. *Mayo* v. *Pioneer Bank & Trust Co.*, 270 F.2d 823 (5th Cir. 1959), *cert. denied*, 362 U.S. 962 (1960).

Conclusion

For all the reasons set forth above and in Franklin's principal brief, the judgment below should be reversed.

Respectfully submitted,

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admitted this 7th day of
Oct. 1974

Signed _____

Attorney for Plaintiffs-Appellees

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